LAURA SEIDL, individually, derivatively and on behalf of all others similarly situated, Plaintiff, vs. AMERICAN CENTURY COMPANIES, INC., AMERICAN CENTURY INVESTMENT MANAGEMENT, INC., JAMES E. STOWERS, JR., JAMES E. STOWERS, III, JONATHAN S. THOMAS, THOMAS A. BROWN, ANDREA C. HALL, DONALD H. PRATT, GALE A. SAYERS, M. JEANNINE STRANDJORD, TIMOTHY S. WEBSTER, WILLIAM M. LYONS, MARK MALLON, WADE SLOME, BRUCE WIMBERLY and JERRY SULLIVAN, Defendants. and AMERICAN CENTURY MUTUAL FUNDS, INC., doing business as AMERICAN CENTURY ULTRA FUND, Nominal Defendant.	INDEX No. 08-CV-8857 (DLC) ECF Case

FUND AND INDEPENDENT DIRECTORS' MEMORANDUM OF LAW IN SUPPORT OF THEIR MOTION TO DISMISS PLAINTIFF'S SECOND AMENDED VERIFIED DERIVATIVE AND CLASS ACTION COMPLAINT

TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

CASES

TABLE OF AUTHORITIES
(Continued)

Page

RULES & STATUTES

MISCELLANEOUS

Defendants Thomas A. Brown, Andrea C. Hall, Donald H. Pratt, Gale E. Sayers, M. Jeannine Strandjord, and Timothy S. Webster (the "Independent Directors")[1] and nominal defendant American Century Mutual Funds, Inc., doing business as American Century Ultra Fund ("the Fund") (collectively, "Defendants"), respectfully submit this Memorandum in Support of Their Motion to Dismiss Plaintiff's Second Amended Verified Derivative and Class Action Complaint ("Second Amended Complaint" or "Sec. Am. Complaint") pursuant to Federal Rule of Civil Procedure 12(b)(6). The claims against Defendants should be dismissed for the further reasons set forth in the motion to dismiss made by the other defendants, and Defendants hereby incorporate by reference the arguments made in that motion. For the reasons set forth below and in the other defendants' motion, Defendants' Motion to Dismiss Plaintiff's Second Amended Complaint should be granted and Plaintiff's Second Amended Complaint should be dismissed with prejudice.

Introduction

Even if Plaintiff could assert the claims in her Second Amended Complaint as direct claims, Plaintiff's Second Amended Complaint fails to plead facts sufficient to establish the participation of the Independent Directors in the transactions at issue. Plaintiff thus has failed to state any claim on which relief can be granted.

---

[1] The Investment Company Act of 1940, 15 U.S.C. §§ 80a-1 to 80a-64, the federal securities law governing the operation of mutual funds, identifies individuals employed by or affiliated with the investment adviser as "interested persons". *See* Section 2(a)(19), 15 U.S.C. § 80a-2(a)(19). The term "independent director" refers to a director who is not an "interested person" of the investment advisor (here American Century Investment Management, Inc. ("ACIM")). *See* Sec. Am. Complaint ¶ 30. Similarly, under Maryland law, a director is independent if he or she is not an interested person under the Investment Company Act. Md. Code Ann., Corps. & Ass'ns. § 2-405.3. The role of these independent directors is to serve on the board as the representatives of shareholders and, in this capacity, to provide oversight of the management process. None of the Independent Directors making this motion are employed by ACIM or otherwise involved in the day-to-day management of the Fund, and the Second Amended Complaint does not allege otherwise. *See* Sec. Am. Complaint ¶¶ 31-38. The Independent Directors note that Timothy S. Webster is no longer a director and that two of the current independent directors (not Defendants herein) were not directors of the Fund during the time period covered by the Second Amended Complaint.

Plaintiff alleges that all defendants violated federal law and certain common law duties by knowingly developing, implementing, or continuing (or conspiring to develop, implement, or continue) an investment strategy causing American Century Mutual Funds, Inc. to purchase shares of PartyGaming, a publicly traded company with an internet gambling website, through the Fund.[2] The crux of Plaintiff's allegations is that each Defendant was directly involved in making, approving, or continuing the decision to purchase shares of PartyGaming. The role of mutual fund directors, however, is oversight of the *management* of the fund, not involvement in the day-to-day operations such as making individual investment decisions. Plaintiff has failed to plead any facts that would make plausible her conclusory allegations that *all* defendants were involved in the decision to purchase shares of PartyGaming. Absent specific factual allegations as to the involvement of the Independent Directors in the challenged transactions, the claims against them must be dismissed.

Moreover, the claims Plaintiff seeks to assert would belong to the Fund and could only be asserted by it. Plaintiff in the alternative seeks to assert claims derivatively on behalf of the Fund, but her derivative claims are fatally flawed because she has failed to make demand on the Fund's board of directors to bring such claims. The allegations of her Second Amended Complaint do not establish under applicable law that demand would have been futile. Indeed,

---

[2] Plaintiff's Second Amended Complaint alleges, among other things, that the Independent Directors violated the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. §§ 1961-68. As Plaintiff explains, this Court previously dismissed the RICO claims asserted in Plaintiff's first complaint applying the same rationale applied in *McBrearty v. The Vanguard Group*, No. 08-civ-7650 DLC (S.D.N.Y.), in which this Court dismissed a nearly identical theory alleged by Plaintiff's counsel. But Plaintiff's First Amended Complaint continued to allege violations of RICO to "preserve her RICO claims pending the McBrearty appeal." Sec. Am. Complaint ¶ 140. Plaintiff's Second Amended Complaint "asserts [the RICO] claims on the same basis, since the McBrearty appeal has not yet been decided." *Id.* However, since Plaintiff filed her Second Amended Complaint, the Second Circuit affirmed this Court's order in *McBrearty* by summary order. *See McBrearty v. The Vanguard Group, Inc.*, No. 09-1445-cv, 2009 WL 4019799 (2d Cir. Nov. 23, 2009), *petition for rehearing and rehearing en banc filed*, No. 09-1445-cv (2d Cir. Dec. 8, 2009).

the ever evolving facts and rationales asserted by Plaintiff simply underscore the lack of justification for her failure to make a demand.

Argument

A. Standard of Review

To state a claim for relief under the pleading requirements established by Rule 8(a)(2),[3] "[f]actual allegations [in a complaint] must be enough to raise a right to relief above the speculative level." *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 555 (2007) (citations omitted). Plaintiff's Second Amended Complaint can survive a Rule 12(b)(6) motion to dismiss for failure to state a claim only if its allegations "state a claim to relief that is plausible on its face." *Id.* at 570. Thus, Plaintiff's Second Amended Complaint must provide "allegations plausibly suggesting (not merely consistent with)" the Independent Directors' involvement in the alleged scheme to invest in an allegedly illegal gambling business. *Id.* at 557.

In deciding a Rule 12(b)(6) motion, the Court must accept the factual allegations in the complaint as true and draw all reasonable inferences in favor of the plaintiff. *Burch v. Pioneer Credit Recovery, Inc.*, 551 F.3d 122, 124 (2d Cir. 2008) (citation omitted). However, "[c]onclusory allegations or legal conclusions masquerading as factual conclusions will not suffice to [defeat] a motion to dismiss." *Achtman v. Kirby, McInerney & Squire, LLP*, 464 F.3d 328, 337 (2d Cir. 2006) (modifications in original) (citation omitted). The plausibility requirement "is not akin to a probability requirement, but it asks for more than a sheer possibility that a defendant has acted unlawfully. Where a complaint pleads facts that are merely consistent with a defendant's liability, it stops short of the line between possibility and plausibility of

[3] Federal Rule of Civil Procedure 8(a)(2) states that a pleading requesting relief must contain "a short and plain statement of the claim showing that the pleader is entitled to relief. . . ."

entitlement to relief." *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949 (2009) (internal quotation marks and citations omitted). Accordingly, "naked assertion[s] devoid of further factual enhancement" are insufficient; instead the complaint must amplify its allegations with "factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Id.* (internal quotation marks and citations omitted). A reasonable inference is not established when a complaint lumps together defendants and does not differentiate their conduct. *See In re Air Cargo Shipping Servs. Antitrust Litig.*, No. MD 06-1775, 2008 WL 5958061, *10-11 (E.D.N.Y. Sept. 26, 2008) (finding Rule 8(a) pleading requirement not met where complaint lumped together all defendants into each allegation while simultaneously suggesting that defendants' conduct was not uniform).

B. The Second Amended Complaint Fails to State a Claim for Relief Against the Independent Directors

Plaintiff's federal and state common law claims for relief against the Independent Directors appear premised upon her assertion that "independent directors of mutual fund directors [sic] are responsible for protecting a mutual fund's investors under a unique 'watchdog' role." Sec. Am. Complaint at ¶ 123. Plaintiff argues that, "[g]iven the legal responsibilities of the Directors and the reports they received," the Independent Directors knew of the Fund's investment in PartyGaming or were reckless in not knowing of the Fund's investment. *Id.* ¶ 128.[4]

Under recent Supreme Court precedent, whether Plaintiff's allegations satisfy the pleading requirements of Rule 8(a)(2), and "nudge[] [Plaintiff's] claims across the line from

---

[4] Plaintiff's Second Amended Complaint is internally inconsistent as it simultaneously asserts in conclusory fashion that "each" of the defendants "knowingly" developed and implemented a plan to violate federal law. Sec. Am. Complaint ¶ 50.

conceivable to plausible," requires a two-pronged analysis. *Twombly*, 550 U.S. at 570. The district court must first "identify[] the allegations in the complaint that are not entitled to the assumption of truth." *Iqbal*, 129 S. Ct. at 1951. The district court then considers the remaining well-pleaded factual allegations "to determine if they plausibly suggest an entitlement to relief." *Id.* Legal conclusions are not considered facts. *See Twombly*, 550 U.S. at 555 ("on a motion to dismiss, courts 'are not bound to accept as true a legal conclusion couched as a factual allegation'") (citing *Papasan v. Allain*, 478 U.S. 265, 286 (1986)). When its conclusory assertions are set aside, the Second Amended Complaint falls far short of meeting the plausibility standard enunciated by the Supreme Court.

1. Plaintiff's Conclusory Allegations are Not Entitled to the Assumption of Truth

The Second Amended Complaint alleges that "[u]pon information and belief, during the course of the conspiracy alleged herein, each of the Directors received regular reports from portfolio managers and other investment personnel concerning the Fund's investments." Sec. Am. Complaint ¶ 126. According to Plaintiff, the Independent Directors received reports as part of their service on a "Fund Performance Review Committee." As described in a Statement of Additional Information ("SAI") filed by ACMF with the Securities and Exchange Commission in October 2006, [5] attached hereto as Exhibit 1,[6] the Fund Performance Review Committee: "reviews quarterly the investment activities and strategies used to manage fund assets. The

---

[5] In her opposition to Defendants' motion for judgment on the pleadings as to the First Amended Complaint, Plaintiff cited the SAI as the basis for her arguments relating to reports received by the Independent Directors. Ex. 17 of Pl. Mem. in Opp. to Defendants' Mots. for Judgment on the Pleadings. She has now incorporated those arguments into the Second Amended Complaint.

[6] When evaluating a motion to dismiss made pursuant to Rule 12(b)(6), "[d]ocuments that are attached to the complaint or incorporated in it by reference are deemed part of the pleading and may be considered." *Kassover v. UBS AG*, 619 F. Supp. 2d 28, 31 (S.D.N.Y. 2008) (citations omitted).

committee regularly receives reports from portfolio managers and other investment personnel concerning the funds' investments." Plaintiff concludes that "[t]hrough those reports and otherwise, each of the Directors became aware, even if they may have been previously been [sic] ignorant, that ACMF, through the Fund, had invested in an illegal gambling business." Sec. Am. Complaint ¶ 126.

However, Plaintiff's "facts" are merely conclusory allegations. Indeed, they exemplify the "[t]hreadbare recitals of the elements of a cause of action, supported by mere conclusory statements," disfavored by the Supreme Court because they seek to establish actual or constructive knowledge based on mere unsupported speculation. *Iqbal*, 129 S. Ct. at 1949 (citing *Twombly*, 550 U.S. at 555). Notably, Plaintiff does not make any allegation as to what information the reports contained. Plaintiff simply speculates that the Independent Directors *might* have received reports providing sufficiently detailed information on every portfolio security of every fund on whose board they sat, including the 90 common stocks held in the Ultra Fund's portfolio. American Century Mutual Funds, Inc., Form N-Q, (Sept. 26, 2005) (cited by Sec. Am. Complaint ¶ 52). The SAI plausibly suggests only that the Performance Review Committee meets four times a year and has responsibility over several portfolios (involving hundreds of portfolio securities). It is far from plausible that mere committee membership establishes knowledge and active involvement by the Independent Directors in the selection or approval of specific portfolio securities.

2. Plaintiff's Legal Conclusions are Not Entitled to the Assumption of Truth

Plaintiff argues in the alternative that, if the Independent Directors did not learn of the Fund's investment in PartyGaming through reports, the Independent Directors were "reckless[] or willful[ly] blind[], either of which is the legal equivalent of actual knowledge." Sec. Am.

Complaint ¶ 128. Plaintiff argues that the role of Independent Directors as "watchdogs," and their "legal responsibility to monitor the fund investment adviser's trading practices" create a presumption of actual knowledge. *Id.* ¶ 125. Plaintiff's alternative theory of knowledge fails to support her causes of action against the Independent Directors, not only because legal conclusions need not be considered as true for purposes of a motion to dismiss, but because Plaintiff misapprehends the law.

Independent directors act as "watchdogs," not to review each portfolio holding of every mutual fund on whose board they sit, but to address conflicts of interest between the shareholders of the fund and fund management. As explained in *Tannenbaum v. Zeller*, 552 F.2d 402 (2d Cir. 1977), directors have a "watchdog" role because "there are important areas in which [management and shareholder] interests may conflict." *Id.* at 405. The Supreme Court similarly explained that the "watchdog" role of independent directors principally involves the oversight of conflicts of interest: "In short, the structure and purpose of the [Investment Company Act] indicate that Congress entrusted to the independent directors of investment companies, exercising the authority granted to them by state law, the primary responsibility for looking after the interests of the funds' shareholders." *Burks v. Lasker*, 441 U.S. 471, 484-85 (1979).

The Securities and Exchange Commission has explained that mutual fund independent directors' role in "monitoring" is simply part of the independent directors' duties in "overseeing the use of fund assets and in monitoring the conflicts of interest faced by a fund's investment adviser. . . ." *Commission Guidance Regarding the Duties and Responsibilities of Investment Company Boards of Directors with Respect to Investment Adviser Portfolio Trading Practices, Proposed Rule*, Release No. 28345, 93 S.E.C. 2469 (July 30, 2008). Accordingly, "directors are not required or expected to monitor each trade" made by the mutual fund's investment adviser.

Id. Stated otherwise, while directors are responsible for monitoring the fund's investment performance, "fund directors are not expected to play an active role in managing a fund's investments." ABA, Fund Director's Guidebook 53 (3d ed. 2006). Thus, Plaintiff's argument, that the Independent Directors' roles as "watchdogs" and their obligation to "monitor the fund investment adviser's trading practices" imputes knowledge of specific portfolio investments, is based upon a miscomprehension of the law and so does not plausibly establish that the Independent Directors were directly involved in the challenged decision.

3. The Second Amended Complaint Does Not Plausibly Suggest Plaintiff's Entitlement to Relief Under Federal or Common Law Theories of Liability

When Plaintiff's conclusory statements and legal conclusions are set aside, the Second Amended Complaint provides no factual allegations relating to the involvement of the Independent Directors that would allow the Court to find that Plaintiff has stated a claim against the Independent Directors for violating federal criminal statutes or common law duties owed to shareholders and ACMF. Even accepting as true allegations that the Independent Directors served alongside Management Directors on the Fund's board of directors and that the Fund purchased shares of PartyGaming in 2005 and 2006, the Second Amended Complaint fails to allege any facts as to the purported involvement of the Independent Directors in the specific investment decision to purchase shares of PartyGaming. The Second Amended Complaint never alleges how, when, or if the Independent Directors approved the Fund's purchase of PartyGaming shares. Such involvement in specific security selection would be inconsistent with their role as one of oversight.

Apparently recognizing the absence of factual allegations supporting any direct involvement by the Independent Directors in the challenged investment decision, Plaintiff accuses the Independent Directors of recklessness, alleging that they were not sufficiently aware

of the decisions to prevent the investment from being made. Sec. Am. Complaint ¶ 128. These allegations likewise fail, as they are based on nothing more than conclusory allegations about reports provided to the Independent Directors concerning the Fund's investments and an attempt to read far too much into the "watchdog" role. *Id.* ¶¶ 123-26. As noted earlier, Plaintiff's allegations with respect to reports merely repeat the statement in ACMF's SAI that the Fund Performance Review Committee has responsibility over several portfolios, meets quarterly, and "regularly receives reports from portfolio managers and other investment personnel concerning the funds' investments." It is mere speculation on Plaintiff's part, however, to suggest that these reports contained detailed information on each portfolio security such that the Independent Directors should have been aware of all possible risks associated with each security. Similarly, Plaintiff's attempt to establish the Independent Directors' violation of a duty by alleging that they had a duty to prevent investments in PartyGaming is both unpersuasive and premised upon a misunderstanding of the role of independent directors. (*See supra*) These and similar allegations are not entitled to the assumption of truth and need not be considered as true in the Court's determination of whether Plaintiff has stated any claim for relief. Therefore, Plaintiff's Second Amended Complaint should be dismissed.

C. Plaintiff's Derivative Claims Must Be Dismissed For the Further Reason That Plaintiff Has Failed to Adequately Plead Demand Futility

As Plaintiff alleges, the Fund is organized under Maryland law. Sec. Am. Complaint ¶ 23. Accordingly, the law of Maryland governs whether claims may be asserted directly by shareholders or instead belong to the Fund and may only be asserted by shareholders as derivative claims. *See Kamen v. Kemper Fin. Servs., Inc.*, 500 U.S. 90, 97-101 (1991) (stating that law of the state of incorporation governs substantive issues of corporate governance). Under Maryland law, the general rule is that "an injury to a corporation can be brought only in the name

of the corporation itself acting through its directors, and not by an individual stockholder though the injury may incidentally result in diminishing or destroying the value of the stock." *Danielewicz v. Arnold*, 769 A.2d 274, 283 (Md. Ct. Spec. App. 2001) (citation omitted). As explained in greater detail in the memorandum of the other defendants, each of Plaintiff's claims is derivative and belongs to the Fund, not to Plaintiff directly.

Because Plaintiff's claims are derivative, in addition to satisfying the *Twombly* and *Iqbal* standards for pleading causes of action, the Second Amended Complaint must comply with Rule 23.1 ("Derivative Actions") and "state with particularity: (A) any effort by the plaintiff to obtain the desired action from the directors or comparable authority and, if necessary, from the shareholders or members; and (B) the reasons for not obtaining the action or not making the effort." Fed. R. Civ. P. 23.1(b)(3). Rule 23.1 imposes a higher pleading standard than required under Rule 8(a). *See, e.g.*, *Halebian v. Berv*, 631 F. Supp. 2d 284, 292 (S.D.N.Y. 2007) ("Thus, derivative suits in federal court must meet 'a pleading standard higher than the normal standard applicable to analysis of a pleading challenged under Rule 12(b)(b).'") (citation omitted). Similarly, Maryland law requires "clear[] demonstrat[ion] in a very particular manner. . . ." *Werbowsky v. Collomb*, 766 A.2d 123, 144 (Md. 2002). Plaintiff's Second Amended Complaint fails to meet this standard.

Rule 23.1 requires that when asserting derivative claims, a complaint must plead with particularity whether demand upon the corporation was made, or why it was not made. As with other substantive issues of corporate governance, questions relating to demand are resolved by applying the law of the state of incorporation. *See Scalisi v. Fund Asset Mgmt., L.P.*, 380 F.3d 133, 138 (2d Cir. 2004). The purpose of the demand requirement is to afford directors an opportunity "to exercise their reasonable business judgment and waive a legal right vested in the

corporation in the belief that its best interests will be promoted by not insisting on such right." *Kamen*, 500 U.S. at 96 (internal quotation marks and citations omitted). The demand requirement also "gives the directors – even interested, non-independent directors – an opportunity to consider, or reconsider, the issue in dispute." *Werbowsky*, 766 A.2d at 144.

Plaintiff acknowledges that she has made no demand on the Fund's board of directors and instead argues she is excused from doing so because demand would have been futile. Sec. Am. Complaint ¶ 132. While demand may be excused when futile, *Werbowsky*, 766 A.2d at 144, Plaintiff's Second Amended Complaint fails to allege facts that would support a finding of futility under Maryland law and thus fails to meet the requirements of Rule 23.1. Under Maryland law, the demand futility exception is:

> a very limited exception, to be applied only when the allegations or evidence clearly demonstrate, in a particular manner, either that (1) a demand, or a delay in awaiting a response to a demand, would cause irreparable harm to the corporation, or (2) a majority of the directors are so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule.

Id. In order to meet the requirements of Rule 23.1 and Maryland law, Plaintiff must state with particularity facts showing that: (1) a demand, or delay in waiting for a response to a demand, would cause irreparable harm; or (2) a majority of the Fund's *current* directors are so personally conflicted or committed to the Fund's purchase of PartyGaming shares that they could not reasonably consider a demand. Establishing futility of demand under the Maryland test is exceedingly difficult. *See, e.g., Washtenaw County Emp. Ret. Sys. v. Wells Real Estate Inv.*

Trust, Inc., No. 07-CV-862-CAP, 2008 WL 2302679, *14 (N.D. Ga. Mar. 31, 2008) (listing over a dozen cases applying *Werbowsky* and finding that demand was required).[7]

1. The Second Amended Complaint Fails to Establish That the Independent Directors Could Not Reasonably Consider a Demand

During the time period at issue, the Fund board was comprised of nine directors, the majority of whom were independent directors, or were not "interested persons" as defined by Section 2(a)(19) of the Investment Company Act.[8] *See* Sec. Am. Complaint ¶ 31-33 (alleging only that two of the director defendants held positions with ACIM or its parent). Plaintiff has failed to allege with particularity that any Independent Director was personally involved in the decision to purchase PartyGaming shares, or that any Independent Director received any benefit from the Fund's holdings of PartyGaming. Even if Plaintiff had alleged specific facts showing that all of the directors personally had approved the purchase of the shares (and she has not so alleged), "[m]ere approval of the challenged transactions . . . is not enough to excuse the failure to make a demand." *In re Franklin Mut. Funds Fee Litig.*, 388 F. Supp. 2d 451, 470 (D.N.J. 2005) (citing *Werbowsky*, 762 A.2d at 143-44). Accordingly, Plaintiff has failed to allege with particularity any facts establishing that the Independent Directors could not reasonably consider a demand.

Nonetheless, Plaintiff argues that demand is futile because: (1) the Independent Directors filed responsive pleadings to Plaintiff's previous complaints, Sec. Am. Complaint ¶¶ 133-57; (2)

---

[7] The lone opinion in which a court found demand was excused, *Felker v. Anderson*, No. 04-0372-CV, 2005 WL 602974 (W.D. Mo. Feb. 11, 2005), has been criticized by two subsequent opinions, *Washtenaw* and *In re CNL Hotels & Resorts, Inc. Secs. Litig.*, No. 6:04cv1231, 2005 WL 2219283 (M.D. Fla. Sept. 13, 2005), as unpersuasive.

[8] The Second Amended Complaint also notes that two current independent directors, who are not defendants in this action, were not directors at the time of the investment transactions at issue. Sec. Am. Complaint ¶ 36. This further undermines Plaintiff's ability to establish that a majority of the *current* board is so personally conflicted or committed to the Fund's purchase of PartyGaming shares such that those directors could not reasonably consider a demand. *Werbowsky*, 766 A.2d at 144.

a majority of the directors "are exposed to a substantial risk of criminal or civil liability," *Id.* ¶ 158; (3) the directors have a "inherent conflicts of interest," *Id.* ¶ 169; and (4) "the wrongdoing of which Plaintiff complains in this complaint constitutes inherently illegal criminal activity that is ultra vires and a per se violation of the business judgment rule," *Id.* ¶ 186. Each argument fails.

i. The Independent Directors' Responsive Pleadings Do Not Excuse Demand

According to Plaintiff, the fact that the Independent Directors have answered the charges of liability she leveled against them shows that they have now "made up their minds" as to the claims in the Second Amended Complaint such that pre-suit demand would have been futile. *Id.* ¶ 147. Plaintiff's argument finds no support in case law.

Plaintiff's argument that, unless they agree with Plaintiff's allegations in a responsive pleading, all defendants are *per se* "so personally and directly conflicted or committed to the decision in dispute that they cannot reasonably be expected to respond to a demand in good faith and within the ambit of the business judgment rule," *Werbowsky*, 766 A.2d at 144, proves too much. Were this the law, any plaintiff could establish futility by simply asserting the liability of the directors and forcing them to defend themselves. Contrary to Plaintiff's argument, demand futility must be established based on pre-suit facts. *See, e.g.*, *Grossman v. Johnson*, 674 F.2d 115, 123 (1st Cir. 1982) ("The futility of making the demand required by Rule 23.1 must be gauged at the time the derivative action is commenced, not afterward with the benefit of hindsight.") (citation omitted); *see also Lewis v. Graves*, 701 F.2d 245, 250 (2d Cir. 1983) (finding insufficient to establish demand futility filing of an answer and a motion to dismiss). "After a suit is filed, the directors may take action in their defense that could be construed as contrary to the claims of the shareholders, but that might not have been taken if a suit had not

been filed." *In re Ferro Corp. Deriv. Litig.*, 511 F.3d 611, 621 (6th Cir. 2008) (citation omitted). *See also Weiss v. Temporary Inv. Fund*, 516 F. Supp. 665, 673 (D. Del. 1981) ("[S]ince the directors of the Fund expressed their opposition to [plaintiff's suit by asserting that the allegations lack merit] only after it was filed, that is not a basis for excusing demand."). These cases make clear that Plaintiff may not establish futility based on events occurring after she filed her complaint.

ii. An Exception to the Demand Requirement for Alleged Exposure to Civil and Criminal Liability is Not Recognized Under Maryland Law

Plaintiff also argues that demand is excused because a majority of the board of directors "are exposed to a substantial risk of criminal or civil liability . . . ." Sec. Am. Complaint ¶ 158. Initially, Plaintiff has failed to allege facts from which the Court could find that Plaintiff has established that any director faces "a substantial risk of criminal or civil liability," much less a majority of the directors. Even if Plaintiff had alleged sufficient facts to establish this assertion, however, her claim of futility would still fail under Maryland law. Although certain decisions applying *Delaware* law have recognized an exception to the demand requirement where there is a substantial threat of liability, we have found no decision expanding the *Werbowsky* test to include such an exception under *Maryland* law, which controls here. No case applying Maryland's test has interpreted the *Werbowsky* test to include this additional exception, because "the futility exception is a narrow one." *Scalisi*, 380 F.3d at 140. As the Second Circuit stated, *Werbowsky* "emphasized the significant value of pre-suit demand in allowing 'directors—even interested, non-independent directors—an opportunity to consider, or reconsider, the issue in dispute. . . .'" *Id.* at 141. Permitting directors (including those who had some involvement in the challenged decision) to re-consider a challenged decision is contrary to the argument that potential liability excuses demand.

Even if Delaware law were to apply, the threat of liability is remote because Plaintiff's RICO claims fail as a matter or law and, more tellingly, in the years since the Fund sold its holdings of PartyGaming, there have been no prosecutions against the directors and "[n]o other litigation concerning this controversy has been commenced. . . ." Sec. Am. Complaint ¶ 190. Prosecution of the CEOs and directors of gambling businesses does not suggest a substantial risk of criminal liability for directors of a mutual fund that purchased publicly traded shares of one such company. Plaintiff has not cited any case, or even any news article, suggesting that any person or entity has been, or will be, charged with violating 15 U.S.C. § 1955 for purchasing shares in a company whose gambling business is found to be illegal. Plaintiff's argument is further undermined by the Second Circuit's recent rejection of the RICO claims asserted in *McBrearty*, as Plaintiff implicitly has acknowledged. In seeking stay of these proceedings pending resolution of the *McBrearty* appeal, Plaintiff stated: "An important consideration in the [sic] determining demand futility is an evaluation of the strength of Plaintiff's claims and the likelihood that the directors would be exposed to criminal or civil liability. The Second Circuit's RICO proximate cause determination will have a *significant* impact on that issue as well." Pl. Letter Mot. at 2 (July 17, 2009) (emphasis added).

Moreover, evaluating whether a majority of the directors face a substantial risk of liability also requires an inquiry into whether a violation of RICO or of a director's fiduciary duties actually occurred. Such an inquiry directly conflicts with the Maryland Court of Appeals' rationale for its limited exception to the demand requirement, that the test "focuses the court's attention on the real, limited, issue – the futility of a pre-suit demand – and avoids injecting into a preliminary proceeding issues that go more to the merits of the complaint. . . ." *Werbowsky*, 766 A.2d at 620. Plaintiff also notes that the Fund's directors would be required to sue

themselves, but "[u]nder Maryland law, these allegations are insufficient to excuse demand."[9] *In re Davis Select Mut. Funds Litig.*, No. 04-civ-4186, 2005 WL 2509732, *3 (S.D.N.Y. Oct. 11, 2005).

iii. Service by Directors on the Boards of Multiple Related Mutual Funds Does Not Excuse Demand

Plaintiff further alleges that the Independent Directors could not reasonably consider a demand because of the "undivided loyalty" each Independent Director owes to the other funds on whose boards they sit. Sec. Am. Complaint ¶ 176. Plaintiff essentially argues that the directors would not bring suit against ACIM because recovery for the Ultra Fund would harm the other portfolios and their investors, investors to whom the Independent Directors owed fiduciary duties. Plaintiff's argument fails for several reasons.

First, Plaintiff's irreconcilable conflict of interest argument is based upon the assertion that "[w]ere the Plaintiffs [sic] to prevail in this litigation, ACIM would be liable to forfeit an amount equal to three times all of the fees it has received on account of its management of the Fund's portfolio . . . ." *Id.* ¶ 180. According to Plaintiff, this recovery from ACIM under the RICO treble damages provision would cause ACIM to provide diminished services to other funds to which the directors owed a fiduciary duty. However, because the Second Amended Complaint "asserts [RICO] claims on the same basis" as those asserted by this Plaintiff's counsel in *McBrearty*, the Second Circuit's summary order affirming dismissal of similar RICO claims eliminates the predicate for this argument.

---

[9] Plaintiff also claims, although not directly, the demand is excused because the investment adviser selects the Fund's board of directors and so the relationship between ACC, ACIM, ACMF and the directors "is fraught with conflicts of interest." Sec. Am. Complaint ¶ 169. Putting aside the fact that Plaintiff ignores the role of independent nominating committees and shareholders in the selection of directors, courts have routinely rejected this argument. *See, e.g., Scalisi*, 380 F.3d 133 (demand required where fund board members chosen by parent company and investment adviser); *In re Franklin Mut. Funds*, 388 F. Supp. 2d 451 (demand required where directors were appointed by investment advisors).

Second, regardless of the holding in *McBrearty*, the *Werbowsky* test does not inquire into whether a successful suit against an investment adviser would possibly harm other mutual funds to which the directors owe fiduciary duties, but only inquires into whether "a majority of the directors are so personally and directly conflicted or committed *to the decision in dispute* . . . ." *Werbowsky*, 766 A.2d at 144 (emphasis added). Here, the decision in dispute is the Fund's investment in shares of PartyGaming, not the consideration of the demand itself.

Third, the central premise of Plaintiff's argument, that service on the boards of multiple funds managed by the same adviser disqualifies directors from considering a demand, has been rejected by numerous courts. For example, one court concluded that, where the shareholders of one particular mutual fund brought a derivative action against the investment adviser, and where the investment adviser managed 49 funds (which in turn controlled over 70 fund portfolios) on whose boards the directors sat, there was no conflict establishing futility of demand under Maryland law. *In re Merrill Lynch Focus Twenty Fund Inv. Co. Act. Litig.*, 218 F.R.D. 377, 380-81 (E.D.N.Y. 2003). Other cases applying Maryland law similarly have concluded that membership on multiple mutual fund boards does not excuse demand, even where the directors must bring suit against an investment adviser managing all of the funds. *See, e.g.*, *In re Franklin Mut. Funds Fee Litig.*, 388 F. Supp. 2d 451 (D.N.J. 2005). Notably, the Court of Appeals for the Second Circuit has examined a factual scenario indistinguishable in all significant respects from this case and concluded that demand was not excused. Applying *Werbowsky*, the Second Circuit concluded that demand was not excused where shareholders of a mutual fund sought to bring a derivative claim on behalf of the fund against the parent of the investment adviser, despite eight of nine independent directors serving on the boards of forty-nine other related mutual funds managed by the same investment adviser. *See Scalisi*, 380 F.3d at 138-42. Each case cited

above involved directors for various funds managed by a single adviser. Had plaintiffs in those cases prevailed, the same harm would have befallen the investors of the other funds as the investors of the ACMF funds managed by ACIM. Such a result was not sufficient to establish demand futility in those cases, and Plaintiff has failed to establish why this Court should deviate from precedent.

Plaintiff attempts to distinguish *Scalisi* and similar cases by stating that the Ultra Fund is a series fund, and that they are not separate legal entities. Sec. Am. Complaint ¶¶ 171-72. However, as one court explained, "the SEC… has expressly pronounced that [where a series mutual fund is involved] each series is to be treated as a separate investment company," *In re Mutual Fund Inv. Litig.*, 519 F. Supp. 2d 580, 588 (D. Md. 2007) (citations omitted), and as Plaintiff states, the series portfolios are different funds with different investors. Therefore, there is no reason to distinguish this case from any other in which a court considered related mutual funds and determined that demand was required. Notwithstanding Plaintiff's attempts to disguise her futility arguments by couching the harm as loss of operating expenses or cessation of subsidies, Plaintiff's argument effectively seeks to establish futility as a matter of law every time directors of a mutual fund have responsibilities to another fund managed by, or receiving services from, the targeted investment adviser. This argument clearly conflicts with the purpose of the demand requirement, and should be rejected.

iv. Plaintiff Cannot Circumvent the Demand Requirement by Simply Alleging Inherently Criminal Activity

Plaintiff argues that demand is futile because the Second Amended Complaint alleges that the defendants engaged in inherently criminal activity. Maryland law does not recognize such an exception to the demand requirement, and to permit a plaintiff to avoid making demand

by simply alleging that directors engaged in inherently illegal criminal activity essentially renders the demand requirement a nullity.

2. The Second Amended Complaint Fails to Establish That Demand, or a Delay in Awaiting a Response to a Demand, Would Cause Irreparable Harm

Plaintiff asserts in her Second Amended Complaint that she meets the first prong of the Maryland test for demand futility—that demand, or a delay *in waiting for a response to demand*, would irreparably harm the Fund. Plaintiff first argues that the Fund would be harmed irreparably because defendants' responses to Plaintiff's initial and first amended complaints foreclose the ability of the Fund to recover, should the Fund choose to bring an action for the common law violations alleged by Plaintiff. Sec. Am. Complaint ¶¶153-56. Plaintiff's argument fails for two reasons. First, the Second Amended Complaint specifically seeks monetary damages, even providing the means by which those damages can be calculated. Sec. Am. Complaint, Prayer for Relief. However, Maryland law considers an injury or harm to be "irreparable" only where "monetary damages are difficult to ascertain or are otherwise inadequate[, and will not find irreparable harm where] Plaintiffs have failed to allege that they could not be adequately compensated for any breach through an award of money damages." *Sekuk Global Enters. Profit Sharing Plan v. Kevenides*, No. 24-C-03-007496, 2004 WL 1982508, at *4 (Md. Ct. Spec. App. May 25, 2004) (finding that Plaintiffs failed to meet first prong of *Werbowsky* test) (citations omittted); *See also Washtenaw County Employees Ret. Sys.*, 2008 WL 2302679, *13 ("Moreover, as both the Maryland court and this court have held, the plaintiff has not established that any damages resulting from the actions complained of in this case will result in irreparable harm. The harm alleged is monetary in nature and can be compensated through monetary damages."). Second, Plaintiff's speculative assertions ultimately are irrelevant because they are based upon facts occurring only *after* filing of her initial

complaint. *See infra* pp. 13-14. Indeed, by relying upon events post-filing, Plaintiff implies that a demand made before filing of her initial complaint would *not* have irreparably harmed the Fund. Accordingly, Plaintiff has failed to establish that making a pre-suit demand would have harmed irreparably the Fund.

Plaintiff next argues that any delay caused by making a demand would irreparably harm the Fund because dismissal of this action would bolster a defense based on the statute of limitations. Sec. Am. Complaint ¶ 157. This argument is spurious. Plaintiff herself waited until August 2008 to bring the first of these actions, *Id.* ¶ 135, and more than a year later, has filed her third complaint in the current action. Plaintiff cannot rely on her own delays to establish purported irreparable harm. *See, e.g.*, *Caston v. Hoaglin*, No. 08-cv-200, 2009 WL 3078214, at *5 (S.D. Ohio Sept. 23, 2009), *appeal docketed*, No. 09-4383 (6th Cir. Nov. 10, 2009) ("Moreover, Plaintiff cannot meet the first prong of the [*Werbowsky*] demand-futility test by listing harms that occurred during the delay he caused by waiting for months to file his amended complaint.").

Conclusion

For the reasons set forth above, the Fund and the Independent Directors respectfully request that the Court grant their Motion to Dismiss Plaintiff's Second Amended Verified Derivative and Class Action Complaint and dismiss Plaintiff's Second Amended Complaint with prejudice.

Dated: December 18, 2009

/s/ David P. Langlois
David P. Langlois (DL 2319)
SUTHERLAND ASBILL & BRENNAN LLP
1114 Avenue of the Americas
40th Floor

New York, New York 10036-7703
Phone: 212-389-5000
Fax: 212-389-5099
Email: david.langlois@sutherland.com

Marguerite C. Bateman *
Steuart H. Thomsen*
SUTHERLAND ASBILL & BRENNAN LLP
1275 Pennsylvania Avenue, NW
Washington, DC 20004
Phone: 202-383-0100
Fax: 202-637-3593
Email: marguerite.bateman@sutherland.com
steuart.thomsen@sutherland.com
(*Admitted Pro Hac Vice*)

Attorneys for Defendants Thomas A. Brown, Andrea C. Hall, Donald H. Pratt, Gale E. Sayers, M. Jeannine Strandjord, and Timothy S. Webster, and nominal defendant American Century Mutual Funds, Inc., doing business as American Century Ultra Fund